Los Angeles County:

Although It Continues To Balance Current Budgets, Financial Uncertainties Linger

March 1997
97018

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CALIFORNIA STATE AUDITOR

March 27, 1997 97018

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by Chapter 518, Statutes of 1995, the Bureau of State Audits presents its audit report concerning Los Angeles County's (county) fiscal condition and the status of issues we previously reported.

This report concludes that the county completed its final budget-balancing action for fiscal year 1996-97 by reducing the net county costs of county departments by $51 million. Also, in January 1997, it opened the Twin Towers jail. Beginning in fiscal year 1997-98, with the passage of Proposition 218 and a September 1995 court ruling regarding Proposition 62, approximately $110 million in annual county taxes and benefit assessment revenues are in jeopardy. Further, in January 1997, the county initially projected a $386 million shortfall for its 1997-98 budget; however, it subsequently revised its estimated shortfall to $212 million. Nevertheless, the county has a history of solving major budget shortfalls and adopting a balanced budget as required by law. Finally, the county is preparing for federal and state welfare reforms, which could have a significant fiscal impact in the future.

Respectfully submitted,

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Table of Contents

Summary

Audit Highlights . . .

By reducing departmental budgets $51 million, Los Angeles County completed its one outstanding budget balancing action for fiscal year 1996-97.

To keep its probation camps opened for fiscal year 1996-97, the county used its entire $29.7 million reserve for budgetary uncertainties.

In January 1997, the county opened Twin Towers, but an agreement to house state parole violators at a county jail is pending.

The county is addressing ongoing and future budget problems by:

- ☑ ***continuing to monitor net county cost projections and***
- ☑ ***reviewing potential effects of federal and state legislative changes.***

For fiscal year 1997-98, the county is projecting a $212 million shortfall. However, it ended each of the last five fiscal years with a fund balance surplus ranging from $127 million to $304 million, after initially projecting shortfalls from $277 million to $1.3 billion.

Results in Brief

Los Angeles County (county) is one of California's original 27 counties and is responsible for providing welfare, health, and safety services to its citizens. Under the provisions of the California Government Code, Section 29088, the county must approve a balanced budget by August 30 each year, but it can extend this deadline to October 2.

The first Bureau of State Audits report, issued in March 1996, described the county's fiscal crisis and how it planned to balance its budget for fiscal year 1995-96. Our second report, issued in November 1996, focused on whether the county achieved its uncompleted budget-balancing actions for fiscal year 1995-96 and how it is balancing its fiscal year 1996-97 budget. Additionally, our second report described how the Los Angeles County Sheriff's Department (LASD) can reduce costs.

In this third of five audits that the California Government Code requires us to perform, we focused on the status of the fiscal year 1996-97 budget and on the status of the fiscal issues described in our previous reports. Specifically, we noted the following conditions:

- The county achieved the budget-balancing action for fiscal year 1996-97 outstanding at the time of our last audit report. It reduced net county costs by $51 million.
- As of June 27, 1996, when the board of supervisors adopted the budget for fiscal year 1996-97, the county had not identified a specific funding source for all of its community regional parks and juvenile probation camps. It subsequently used a combination of current-year reserves, estimated departmental savings, and one-time sources to fund operations of these two organizations.
- In January 1997, the county opened the Twin Towers Correctional Facility (Twin Towers), a 4,192-bed jail completed in June 1995. However, the LASD needs

to complete contract negotiations with the State to house state prisoners and to fully implement its plan to operate Twin Towers.

- The county continues to face other fiscal challenges in the future. As of January 1997, the county projected a $386 million shortfall for its 1997-98 budget, although it subsequently revised this estimated shortfall to $212 million.

- Beginning in fiscal year 1997-98, with the passage of Proposition 218 and a September 1995 court ruling regarding Proposition 62, approximately $110 million in annual county taxes and benefit assessment revenues are in jeopardy. Proposition 218 limits the county's ability to levy general and special taxes without voter approval and property-related benefit assessments without property owner approval. Further, a September 1995 California Supreme Court ruling upheld the constitutionality of Proposition 62, which requires voter approval of all new local taxes.

- The county is preparing for federal and state welfare reforms, which could have a significant fiscal impact on both future costs and funding.

Recommendations

To achieve a balanced budget for the current and future fiscal years, the county should take the following steps:

- Continue its practice of closely monitoring all departments to ensure that they reach their net county costs for the remainder of the fiscal year.

- Finalize agreement with the State to house state prisoners and to generate the revenue needed to operate Twin Towers.

- Monitor closely the potential fiscal impacts of litigation affecting benefit payments, revenue collection, and welfare reform.

- Continue ongoing efforts to anticipate and seek solutions to future budget challenges.

Agency Comments

The county generally agrees with our recommendations and is continuing with efforts to implement them. In addition, the board of supervisors (board) took action on March 4, 1997, to place a special tax on the June 3, 1997, ballot for voter approval to replace the fire suppression benefit revenues jeopardized as a result of the passage of Proposition 218 in November 1996. The board also approved placement of a special tax on the same ballot to fund county public library services and replace community facilities district revenues similarly endangered as a result of Proposition 218.

Introduction

Background

Established in 1850, Los Angeles County (county) is one of California's original counties. Located in the southern coastal portion of the State, it covers 4,083 square miles and in 1996 had a population of 9.4 million people. The county has more people than 42 states in the United States, and it has the highest population of any county in the nation.

Under provisions of its charter, its ordinances, and state and federal mandates, the county is responsible for providing welfare, health, and safety services and for maintaining public records. It provides health services through a network of county hospitals, comprehensive health centers that provide the same level of services as primary care and diagnostic centers as well as urgent care and some specialty services, and health centers. It also provides municipal services to and operates recreational and cultural facilities in the unincorporated areas, and furnishes services such as law enforcement and public works to cities within its borders, which reimburse the county for the costs.

A five-member board of supervisors (board) governs the county and is elected to four-year alternating terms. The assessor, district attorney, and sheriff are also elected officers. Officials appointed by the board head all other departments. The county operates on a fiscal year that runs from July 1 through June 30. Under the provisions of the California Government Code, Section 29088, the board is responsible for approving a balanced budget by August 30 of every fiscal year, and it can extend this deadline to October 2.

Findings That Appeared in Previous Reports by the Bureau of State Audits

In March and November 1996, the Bureau of State Audits issued reports that dealt with budget issues the county faces. In these audits, we found that the county achieved balanced budgets in fiscal years 1995-96 and 1996-97 after initially announcing shortfalls of $1.3 billion and $517 million, respectively. The county dealt with budget shortfalls by

reducing department budgets, instituting a hiring and wage freeze, obtaining federal financial assistance to restructure its health care delivery system, using surplus retirement system investment earnings to satisfy its current pension obligations, and utilizing the previous year's ending fund balance.

In both previous audits, we also examined future budget challenges the county faces. These challenges include potential increased costs resulting from federal welfare reform and litigation surrounding the county's reduction of general assistance programs that could lead to potential liability. Further, in our last report, we reported that the Los Angeles County Sheriff's Department (LASD) could reduce costs by about $4.3 million by converting the positions of 141 sworn officers to civilian status. In addition, the county could save over $1.2 million by closing the jail bakery and contracting out for baked goods. Also, the LASD could potentially reduce costs $25.4 million to $33.6 million by using civilian corrections officers instead of sheriff's deputies to staff its jails. Finally, we reported the county's need to look for long-term solutions rather than short-term remedies to balance its budgets.

The county's chief administrative officer and auditor-controller generally agreed with our recommendations to achieve future balanced budgets. The LASD, however, agreed with some of the recommendations we made regarding its operations but did not agree with others. In this report, we discuss the status of the budget issues covered in our previous audits.

Scope and Methodology

The California Government Code, Section 30605, mandated that the Bureau of State Audits review the county's fiscal condition as well as determine past conditions and actions that have contributed to budget shortfalls. In our first audit, we reviewed the county's fiscal year 1995-96 budget and examined past events that led to the county's fiscal crisis. We issued the report covering this first audit required by the California Government Code in March 1996.

In addition, the California Government Code, Section 30606, mandates that the Bureau of State Audits perform four semiannual reviews of the county's finances. These semiannual reviews are to include both an analysis of whether the county is closing its budget gap and a follow-up on our previous audits. We issued the report covering the first of these four reviews in November 1996. The current audit is our second semiannual review of the county's fiscal condition.

To determine whether it is closing its budget gap, we evaluated the county's actions to maintain a balanced budget for fiscal year 1996-97. Specifically, we reviewed its estimates of current-year general fund and Health Services/Hospital Enterprise Funds revenues and expenditures based on four months of actual data. We reviewed the reasonableness of these estimates by analyzing supporting budget documents and reports. Further, we interviewed budget analysts in the county's chief administrative office and in selected departments. Finally, we determined the effect of the board's decisions on the budget for fiscal year 1996-97.

To follow up on issues, findings, and recommendations in our previous audits, we reviewed the county's actions in response to the audits. We determined if all departments required to implement budget cuts are on target in reducing net county costs for fiscal year 1996-97. We reviewed the county's progress in restructuring its health care delivery system in Phase II of the 1115 Waiver, which is a health relief package designed to help accomplish this. We also reviewed the county's efforts to secure federal funds to finance its probation department. Further, we determined the status of the LASD's plan to open the Twin Towers Correctional Facility, a 4,192-bed jail completed in June 1995. We also reviewed the county's monitoring of potential fiscal impacts of future budget uncertainties related to welfare reform, general assistance litigation, and Propositions 218 and 62. Finally, we evaluated whether the county continues the hiring and employee salary freeze and continues its efforts to control authorization of overtime.

The Government Code provisions that directed us to perform these audits, further directed us to recommend improvements in the effectiveness of county operations. Therefore, to address whether the county can further improve its operations, we will soon initiate an audit of the county's systems for procuring goods and services.

Chapter

Los Angeles County Is on Target To Balance Its Fiscal Year 1996-97 Budget, but Future Budget Uncertainties Remain

Chapter Summary

As we reported in our November 1996 audit report, Los Angeles County (county) identified four major budget-balancing actions to close a $730 million gap and balance its fiscal year 1996-97 budget. That audit found the county had achieved three of these actions totaling $679 million. It received a $172 million increase in health-related revenues through continued approval by the federal government of a health-relief package, known as the 1115 Waiver; received $223 million in surplus investment earnings from the Los Angeles County Employees' Retirement Association to satisfy its fiscal year 1996-97 pension obligation; and utilized fund balances from fiscal year 1995-96 totaling approximately $284 million.

On September 12, 1996, the board of supervisors (board) adjusted the budget it previously had approved for various departments by reducing net county costs for all affected departments a total of $51 million. With this action, it balanced the 1996-97 budget.

As of October 31, 1996, the county estimated it will end the current fiscal year with a general fund balance of approximately $7 million and a balance in its Health Services/Hospital Enterprise Funds of $20.9 million. However, to ensure that net county costs—the amount of expenditures that exceed revenues and must be covered by the general fund—remain on target for the remainder of fiscal year 1996-97, the county must continue to limit additional spending requests and maintain current restrictions on spending such as freezes on hiring and employee wages.

Although it adopted a balanced budget for fiscal year 1996-97, the county still had the challenge of securing funding for its community regional parks and probation department. To resolve these funding issues, the county used a combination of current-year reserves, estimated departmental savings, one-time sources, and proceeds from a federal grant.

In addition, the county opened the Twin Towers Correctional Facility (Twin Towers) at the end of January 1997. However, it needs to complete contract negotiations with the State for housing state prisoners and fully implement its fiscal plan to help pay for operating Twin Towers.

As discussed in previous reports, the county continues to face other challenges that may affect the budgets of future fiscal years. Specifically, the passage of Proposition 218 and a September 1995 court ruling regarding Proposition 62 have placed approximately $110 million in annual county taxes and benefit assessments in jeopardy. The county is also preparing for federal and state welfare reform.

The County Took Action To Balance Its Fiscal Year 1996-97 Budget

The county reduced the current fiscal year budget by $51 million.

To help balance the county's fiscal year 1996-97 budget, departments needed to reduce their costs by a total of $51 million. In September 1996, the board approved budget reductions, and the county's chief administrative officer adjusted the budgets of all affected departments by a total of $51 million. As long as the departments do not exceed these adjusted amounts, the county will succeed in meeting its budget for the current fiscal year.

During the fiscal year, the county chief administrative office (CAO) monitors all departments to ensure they meet their budgets. As of October 31, 1996, the departments estimated their expenditures and revenues and identified any pending factors that may cause their estimates to change significantly between the date reported and fiscal year end. Based on these estimates, the county projects that it will end fiscal year 1996-97 with a general fund balance of approximately $7 million and a Health Services/Hospital Enterprise Funds balance of $20.9 million.

As of October 31, 1996, only one department, Parks and Recreation, reported an increase of net county costs exceeding $1 million over its adopted budget, while three departments estimated decreases in their net county costs greater than $1 million. The vast majority of other departments projected that they would end the fiscal year close to target. Combined, the other departments projected their spending at $1.7 million under budget for the fiscal year. Table 1 summarizes the components of the county's estimated ending fund balances for fiscal year 1996-97 based on four months of actual data.

Table 1

Departments Underspending or Overspending Their Budgets by More Than One Million Dollars in Fiscal Year 1996-97[1] (In Millions)

	Underspent (Overspent)	
Budget Unit	**General Fund**	**Health Services/ Hospital Enterprise Funds**
Operating budgets:		
Health Services	$ 5.8	$20.9
Municipal Courts	1.5	
Parks and Recreation	(1.0)	
Public Social Services	3.1	
Other departments	1.7	
Total Operating Budgets	11.1	20.9
Nonoperating budgets[2]	(4.2)	
Total Projected Underspending	**$ 6.9**	**$20.9**

[1]Estimate based on four months of actual data, ending October 31, 1996.

[2]Primarily decrease in Motor Vehicle License Fee Realignment revenue.

Through the remainder of the year, some departments' net county costs may increase while others may decrease. In addition, actual revenue received during the year may vary from projections. Some departments expect decreases because of hiring freezes or delays in filling positions. Others, however, have incurred overtime costs exceeding amounts budgeted but may offset these costs by reductions in other areas such as services and supplies.

On February 26, 1997, in the revised budget forecast for fiscal year 1997-98, the chief administrative officer estimated the fund balances carried forward from fiscal year 1996-97 to be $60 million for the general fund and $94.4 million for the Health Services/Hospital Enterprise Funds.

The County Has Been Unsuccessful in Transferring Operational Responsibilities for County Parks to Cities

The county will use savings from other departments to cover the Parks and Recreation shortfall.

On June 26, 1996, the board instructed the Parks and Recreation Department to continue operating four community regional parks through the summer months and to contact the cities in which these parks are located regarding their willingness to accept financial responsibility for future operation. The county will spend approximately $1.8 million to operate the parks in fiscal year 1996-97. Initially, the county planned a phased transfer of up to eight community regional parks to cities beginning July 1, 1996. However, in February 1997, it became apparent that the cities would not accept the county's offer. To fund the parks for the remainder of the year, the county's chief administrative officer recommended using savings identified in other departments' budgets. On February 4, 1997, the board approved this transfer of funds.

The transfer of projected savings means $1.8 million less is available to offset any overspending of other departments' budgets. However, this transfer does not affect the county's estimated fund balance.

The County Funded Probation Camps From a Variety of Sources

As of January 1, 1996, the federal government stopped reimbursing counties for probation costs under the Social Security Act, Title IV-A Emergency Assistance program. To help offset this loss, in February 1996, the governor signed AB 1483 (Chapter 7, Statutes of 1996), which provided $17 million in state funds for the county's probation camps. This funding allowed the county to keep its 18 camps open for the remainder of fiscal year 1995-96.

The Probation Department projected total camp costs of approximately $67 million for fiscal year 1996-97. During fiscal year 1996-97, the county decided to continue funding the probation camps while working with the State Department of Social Services to secure funds for the county Probation Department. The county estimated it would need a total of $48.5 million to operate juvenile camps and halls, including juvenile placement and administrative costs.

Although the 1996-97 budget adopted by the county assumed that the federal or state governments would provide funding for Probation Department operations, no such funding has been secured. As a result, the county's chief administrative officer has considered several alternative methods to replace the loss of Title IV-A Emergency Assistance funding, including securing federal or state revenue consistent with the welfare reform block grant, as well as reducing probation program costs. On January 23, 1997, the board approved the county chief administrative officer's recommendation to fund the Probation Department's shortfall from current-year operating reserves and one-time sources. While the governor has responded to the county's predicament by including funding for the county's probation operations in fiscal year 1997-98 in the State's proposed budget, the county has concluded that there is little likelihood that state funding will be available before June 30, 1997.

Table 2

Sources of Funding for the Probation Department's Shortfall in Fiscal Year 1996-97 (In Millions)

Source	Amount
Fiscal year 1996-97 reserve for uncertainties	$29.7
Portion of proceeds from sale of county land	8.4
Proceeds from U.S. Department of Justice, State Criminal Alien Assistance Program grant	10.4
Total	**$48.5**

While the county addressed the ongoing community regional park funding issue with an ongoing source of revenue from projected savings in other departments, it addressed the 1996-97 Probation Department shortfall with one-time funding sources. As illustrated in Table 2, in addition to using nearly $30 million of the county's 1996-97 reserve for budgetary uncertainties, funding was obtained from land sales and a federal grant.

Probation camps were funded with proceeds from a land sale, transfer of federal program funds, and the county's budgetary reserve.

The county used approximately $8.4 million of the $10.9 million proceeds from the sale of a parking lot located immediately across from the Los Angeles County Hall of Administration to partly fund the probation camps. It also used approximately $10.4 million of a $12 million grant from the

U.S. Department of Justice for the State Criminal Alien Assistance Program (SCAAP). The SCAAP grant reimburses costs the county already incurred for the imprisonment of undocumented criminal aliens. The SCAAP grant can be used for correctional or criminal justice purposes or activities normally funded by the county's general fund.

The County Opened Twin Towers Correctional Facility, but Its Fiscal Plan for Financing Jail Operations Is Not Yet Finalized

Although it has completed actions to cover the costs of operating regional parks and probation camps, the county has not yet found enough resources for operating Twin Towers. The county has struggled with opening and funding Twin Towers for nearly 20 months.

The county completed the 4,192-bed Twin Towers in June 1995 but delayed opening it until January 1997 because the original budget proposed by the Los Angeles County Sheriff's Department (LASD) required $100 million in new county funding, and the county had no extra funds in its general fund. Once it realized the board would not authorize funding for the original budget, the LASD began developing a revised plan for opening Twin Towers. Finally, on October 10, 1996, the board approved the revised plan, which is projected to cost $14.4 million in new county funding in fiscal year 1996-97. The approved plan included opening Twin Towers, adding jail beds to current facilities, contracting out jail beds to the state and federal governments, moving prisoners among facilities, and renovating several jails. On January 25, 1997, the county opened Twin Towers by moving approximately 200 maximum-security inmates into the facility.

A significant feature of the approved plan was to generate revenue by contracting with the State and federal government.

A significant feature of the approved plan calls for the LASD to provide 1,900 beds at existing county jails to prisoners under the jurisdiction of the State and federal government. In January 1997, the county estimated revenue from these contract beds for the last five months of fiscal year 1996-97 at $9.4 million and fiscal year 1997-98 at $36 million.

On January 29, 1997, the LASD and the United States Immigration and Naturalization Service signed the contract to house 500 prisoners at the county's Mira Loma jail. Effective February 24, 1997, the contract provides for payment to the county of up to $7.2 million through September 30, 1997.

The State Joint Legislative Budget Committee, however, recommended on February 4, 1997, that the State Department of Finance not approve a contract between the county and the State Department of Corrections that would provide $137 million over five years for housing 1,400 state parole violators at the county's Peter Pitchess Detention Center. On February 27, 1997, the Joint Legislative Budget Committee held a hearing to discuss the contract; however, it has deferred action on the contract pending changes that could reduce the cost to the State.

The five-year contract to house 1,400 state parole violators and to generate $137 million in revenues has not been signed.

According to the county, the contract with the State was not scheduled to become operational until March 1, 1997. The State's delay in signing the agreement has therefore not yet affected net county costs for the current fiscal year. In addition, the chief administrative office estimate of net county costs for fiscal year 1997-98 is unchanged, pending final action on the state contract.

The County Is Addressing Some Future Budget Uncertainties

As it has done in the past, the county began the budget process for the upcoming fiscal year by projecting a significant budget shortfall. For fiscal year 1997-98, it initially projected a budget shortfall of $386.4 million. As of February 26, 1997, the county revised its initial budget projections to a shortfall of $212.6 million. However, the latest county projection does not include $149 million from the federal government for a health relief package, known as the 1115 Waiver, that it may have to return over the next two years.

Furthermore, with the passage of Proposition 218—a proposition that established new requirements for voter approval for property-related assessments, fees, and charges—and a recent court ruling regarding Proposition 62, a similar proposition, after June 30, 1997, the county may not be able to collect or may need to refund approximately $110 million to taxpayers. Finally, the county is facing additional future funding uncertainties with the reforms in federal and state welfare programs.

The County Has a History of Solving Its Major Budget Issues

Despite projected budget shortfalls in each of the fiscal years since 1991-92, the county has managed to adopt a balanced budget and end the fiscal year with a fund balance surplus. Each year the county CAO prepares budget projections for the general fund which includes all departments except the Health Services Department (health services). Also, it prepares budget projections for health services which consists of contributions from the general fund and moneys from the Hospital Enterprise Funds. Although in recent years the general fund has not been able to provide more than the legally required level of funding for health services, the CAO includes the health services budget projections because of health services' tremendous service impact on county residents and because of the need for the board to address major health services budget issues.

Despite repeatedly projecting an initial shortfall, the county continues to end each year with a fund balance surplus.

In January, which is six months before the start of the upcoming fiscal year, the CAO provides the board with its preliminary projections of the upcoming fiscal year's budget. These preliminary projections serve as a starting point for the CAO, county departments, and the board to begin addressing the upcoming year's major budget issues. Because of the uncertainty of the fund balance element, the initial forecast does not include projections of the current year's ending fund balance. The county has been able from January to August to find solutions to its major budget issues that eliminated projected shortfalls and enabled it to adopt a balanced budget for each of the last six fiscal years. The county has used the following primary solutions to eliminate its projected budget shortfalls:

- curtailments, such as reduction of departmental budgets;
- countywide hiring freezes and layoffs of over 2,000 health services employees;
- no salary increases since approximately September 1992;
- substantial increase in revenues from the 1115 Waiver;
- one-time funding sources such as using excess earnings from the Los Angeles County Employees' Retirement Association to satisfy the county's pension obligation; and
- prior-year fund balance surpluses.

Furthermore, each year the county ended the fiscal year with a fund balance surplus. Table 3 shows the CAO's initial projected budget shortfalls and the actual fund balance surpluses at the end of each fiscal year.

Table 3

A Look at Initial Shortfall Projections Contrasted to the Actual Year-end Surpluses (In Millions)

		Actual Ending Fund Balance Surplus		
Fiscal Year	**Initial Projected Budget Shortfall**	**General Fund**	**Health Services/Hospital Enterprise Funds**	**Total**
1991-92	$ (277.0)	$126.8	$ 0.0	$126.8
1992-93	(531.6)	214.9	0.0	214.9
1993-94	(1,163.9)	291.8	12.0	303.8
1994-95	(1,236.4)	208.5	72.6	281.1
1995-96	(1,270.1)	91.7	191.8	283.5
1996-97	(516.7)	60.0*	94.4*	154.4*

*Estimate based on revised initial forecast as of February 26, 1997.

As of January 28, 1997, the CAO projected a budget shortfall of $386.4 million for fiscal year 1997-98. However, by February 26, 1997, it had reduced its projected budget shortfall to $212.6 million. The CAO continually refines its initial budget projections as it gains additional information about departmental, state, federal, and other budgetary needs and financing.

The County May Have To Return Approximately $149 Million of 1115 Waiver Funding

As reported in our November 1996 report, the county received approval of Phases I and II of the 1115 Waiver for fiscal years 1995-96 and 1996-97, respectively, which brought more than $536 million in federal aid to the county. Overall, the 1115 Waiver is designed to stabilize the county health care system and to eventually move it away from expensive inpatient hospital services toward community-based primary and preventive care services. In addition, the county used the 1115 Waiver funds to help balance its budget for the two years it has received them.

While the county is confident that it will continue to receive funding for the 1115 Waiver, it may have to return approximately $149 million of 1115 Waiver funding it received in fiscal year 1995-96 over the next two years. In our first report, we noted that county hospitals serving a disproportionate share of indigent patients faced a potential reduction in California Medical Assistance Program (Medi-Cal) revenues as a result of hospital-specific limits on federal funding adopted by Congress in the Omnibus Budget Reconciliation Act of 1993 (OBRA '93). The disproportionate share hospital program under Medi-Cal, known as SB 855, provides additional Medi-Cal funding to hospitals that provide service to an exceptionally large number of Medi-Cal or other low-income patients. When the State calculated the OBRA '93 limits on the county hospitals' SB 855 payments for fiscal year 1995-96, it did not take into consideration certain funds the county was to receive as a result of the 1115 Waiver. The county estimates that it received approximately $149 million in federal SB 855 funds that may have been in excess of the OBRA '93 limits.

The county may have to return approximately $149 million in 1115 Waiver funding.

Under the 1115 Waiver provisions, however, the federal government must determine if the OBRA '93 limits were exceeded in 1995-96, and if so, by how much, before any funds are to be paid back. The amount of the excess SB 855 payments will be determined no earlier than December 31, 1997. Repayment of any excess is due on an installment basis starting the quarter following the determination. If the federal government determines that the county received excess SB 855 funds in fiscal year 1995-96, the county may have to repay approximately $45.8 million in fiscal year 1997-98, with the remainder of the $149 million due the following year. Consistent with the special terms and conditions of the 1115 Waiver, our estimate of the amount the county may have to repay is based on a repayment schedule in the Code of Federal Regulations, Title 42, Section 430.48. Although the county has $24 million in trust for repayment of possible excess SB 855 funds received in fiscal year 1995-96, it has not included any provisions in its budget projections for fiscal year 1997-98 for the remaining $21.8 million that may be paid during that year.

The county believes that it should receive a larger portion of the funds available in the SB 855 program because its six hospitals have such a large portion of the State's total indigent patient days. An indigent patient is an individual who meets specified income and poverty levels. In fiscal year 1995-96, the county received only about $112 million, 24.7 percent of the more than $453 million in federal funds available that year for the SB 855 program statewide. However, county hospitals had approximately 55 percent of the State's indigent patient days

that year. The county thus contends that the State's funding formula for the SB 855 program is no longer equitable because of the large number of indigent patients in the county. In its efforts to have the State's funding formula for the SB 855 program adjusted, the county has been working with the National Association of Public Hospitals and the federal Health Care Financing Administration. The county also is hopeful President Clinton's proposed budget for fiscal year 1997-98 will contain a proposal for retargeting SB 855 funds to its benefit.

Continued Collection of Some Taxes and Assessments May Be in Jeopardy

Proposition 218 amended the state constitution by establishing new requirements for voter approval of property-related assessments, fees, and charges. Proposition 218 also extends to all charter cities as well as general law cities and counties, the requirement of Proposition 62 (passed by voters in 1986) that voters approve all general taxes.

The passage of two propositions may place $110 million in annual county taxes and benefit assessment revenues in jeopardy.

According to the county, the passage of Proposition 218 and a recent court ruling regarding Proposition 62 have placed approximately $110 million in annual county taxes and benefit assessment revenues in jeopardy after June 30, 1997.

In November 1996, the voters approved the "Right To Vote on Taxes Act" (Proposition 218), which limits the county's ability to levy general and special taxes without voter approval and property-related benefit assessments without property owner approval. The actual effects of Proposition 218 are unclear at this time. The county believes that property owner approval may be needed to continue to collect benefit assessments for the Fire Protection District (approximately $52 million annually) and the Public Library Fund (approximately $9 million annually) after June 30, 1997. However, regardless of whether property owner approval is obtained, these benefit assessments could be subject to challenge based on a number of other provisions of Proposition 218, which will require clarification and interpretation by the courts. These assessments are collected for special funds and do not affect the county's general fund.

On November 22, 1996, the chief administrative officer and the county counsel informed the board that it was unclear whether the retroactive aspect of Proposition 218 applies only to taxes newly imposed or any increase to existing taxes that occurred after January 1, 1995, or it applies also to the base amount of the increased taxes. Further, they explained that Proposition 218 is entirely silent regarding taxes that were

imposed prior to, and not increased after, January 1, 1995. In *"Understanding Proposition 218,"* a booklet issued in December 1996, the state legislative analyst stated that because Proposition 218 sets a July 1, 1997, deadline for local governments to bring existing fees and assessments into conformity with the measure's requirements, legislative or judicial clarification is needed as soon as possible.

Proposition 218 requires voter approval by November 1998 for a county to continue to collect taxes "imposed, extended, or increased" after January 1, 1995. The county's general fund annually receives $19 million in general taxes that might be affected by this provision.

In addition, the California Supreme Court in September 1995 upheld the constitutionality of Proposition 62, a 1986 initiative that requires voter approval of all new or increased local taxes. Certain taxes first imposed or increased without voter approval after the effective date of Proposition 62 may be invalidated. As of the end of July 1996, the California Supreme Court has provided no further clarification about whether its decision will apply only to new taxes or retroactively to all Proposition 62 taxes since the proposition's inception. Accordingly, the county is uncertain about the validity of taxes currently being collected. By June 30, 1997, the county will have reserved approximately $55 million if such collections need to be refunded: $6 million in new or increased taxes from fiscal year 1995-96 and an estimated $49 million in Proposition 62 taxes.

The County Is Preparing for Federal and State Welfare Reform

The welfare reform bill could significantly affect future costs on county health care and social services.

The federal welfare reform bill, known as the Personal Reconciliation and Work Opportunity Reconciliation Act of 1996 (act), could significantly affect the future cost of the county's health care and social programs. The act repeals and amends several major public assistance programs, including Supplemental Security Income and Aid to Families With Dependent Children (AFDC). The act additionally allows the State to choose how it will implement certain provisions. On January 14, 1997, the county Public Social Services Department presented to the board its initial analysis of the impact of the State's welfare reform proposal (State's proposal) on the county. At this time, the impact can only be assessed in general terms because many provisions in the State's proposal are not yet final.

The county's initial analysis indicates that as early as August 1997 elderly and disabled legal immigrants who are not citizens would lose their State Supplemental Payments (SSP) and federal Supplemental Security Income (SSI). Since current state law links In-Home Supportive Services (IHSS) eligibility to SSI eligibility, noncitizen legal immigrants who lose SSI will also become ineligible for IHSS. However, the State's proposal assumes that most legal immigrants will regain eligibility for SSI by becoming naturalized citizens. Regaining SSI eligibility should also make them eligible for IHSS. County social workers have begun contacts with legal immigrants who receive IHSS, encouraging them to pursue citizenship. The county states that early indications are that these efforts by its social workers have been successful. Furthermore, the county Public Social Services Department sent notices to all current legal immigrants who receive SSI. Legal immigrants who lose SSI benefits would be eligible for general assistance, under current state law, which could increase the county's costs up to $236 million.

The State's proposal also eliminates the state mandate that requires counties to provide general assistance payments. The State intends to give local governments flexibility to determine what kind of program may best suit this population in their area and will allow each county's program to differ based on need. Rather than giving flexibility to design a program that specifically suits its general assistance population, the county believes the State should create an alternate statewide program to replace general assistance. It believes a statewide program would prevent potential client migration from counties with lower cash grants to counties with higher cash grants. Consequently, the county will advocate for the creation of such a program.

The county believes it needs more money to fund its GAIN program to achieve the State's "welfare to work" goal.

Additionally, according to the county Public Social Services Department, to provide Greater Avenues to Independence (GAIN) services to all those in danger of losing their AFDC cash assistance under the State's proposal would require an estimated $200 million annual increase in GAIN funding from the State just for the county. The county states that it needs the increased funding to prepare the remaining nonexempt AFDC recipients that are not currently active in the GAIN program for entry-level jobs. Since a major theme of the State's proposal is to move welfare recipients from "welfare to work" and the county's GAIN program has been very successful in moving AFDC recipients into entry-level jobs, the estimated additional funds are crucial to the county achieving the State goal.

Conclusion

The county took a number of actions to achieve a balanced budget for fiscal year 1996-97. However, it will need to continue monitoring individual departments to ensure that they meet their budgets for the remainder of the fiscal year. In addition, by using current-year reserves, the departments' estimated savings, and one-time sources to fund regional parks and Probation Department operations, the county could face difficulty locating other funding sources should other needs arise during the last five months of fiscal year 1996-97. Also, the county still needs to reach agreement with the State on housing state prisoners to fully implement its fiscal plan to operate Twin Towers.

The county continues to face the challenge of dealing with the effects of Propositions 218 and 62. Both may limit future revenue and require refund of fees and assessments already collected. Further, the county must manage the financial ramifications of welfare reform. Although the fiscal impact of these challenges remains uncertain, the county must address these issues soon, or it may have difficulty meeting the State's balanced-budget requirement in future fiscal years.

Recommendations

To continue achieving balanced budgets, the county should take the following steps:

- Continue to closely monitor each department to ensure that it does not exceed its projected net county costs for the remainder of the fiscal year.

- Finalize agreement with the State to generate revenue needed to fully implement its plan for operating Twin Towers.

- Closely monitor future budget challenges related to litigation affecting benefit payments, revenue collection, and welfare reform.

- Continue to plan in advance to mitigate potential negative fiscal impacts before they occur.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: March 27, 1997

Staff: Steven M. Hendrickson, Audit Principal
Jeffrey A. Winston, CPA
Jerry A. Lewis

Appendix

Status of Issues Noted in Our Two Previous Audits of Los Angeles County's Budget

In March and November 1996, we issued reports discussing the status of the Los Angeles County (county) budget. In this appendix, we address the status of some issues described in these reports.

Overtime Controls Continue To Need Additional Improvement

During our March 1996 audit, we found that increased overtime was contributing to the county's fiscal crisis. Moreover, we found that some overtime had not been pre-authorized, as required by county procedures. In response to that audit, the county imposed an additional procedure, which requires that departments submit a quarterly request for overtime authorization to the county's chief administrative office (CAO). However, during our November 1996 audit, we found that some departments decided not to follow the new procedure because they believed it was too cumbersome. Since our November 1996 audit, the county's position, policies, and procedures regarding overtime have not changed. The county continues to require departments to submit a quarterly request for overtime authorization. However, some departments continue to submit the required requests late or not at all.

As of November 15, 1996, 14 departments had not submitted their overtime requests for the second quarter of fiscal year 1996-97, 50 days after the deadline. By December 31, 1996, countywide overtime expenses totaled $106.8 million, 124 percent of the total overtime expenses incurred during the same period in fiscal year 1995-96. The $106.8 million, which was incurred for only half of the fiscal year, amounts to 76.3 percent of the county's 1996-97 overtime budget.

Even though overtime is a major county expense that can greatly affect net county cost, the CAO and most departments, place a greater emphasis on overall net county cost rather than on a single line item such as overtime because budgets are controlled at a higher level of expenditure, such as salaries and employee benefits, services and supplies, etc. For example, if it

underspends its budget for services and supplies to cover the amount it overspends for salaries and employee benefits which include overtime costs, a department's overall budgeted net county cost is not affected.

The CAO told us, nevertheless, it still continues to review its overtime policies and procedures in an effort to better control or limit overtime expenses. Additionally, the CAO is still considering the suggestions of the administrative deputies of county departments for a possible modification to the procedures for overtime requests that would make them less cumbersome and more effective.

The County Is Continuing Its Hiring and Wage Freeze

In our November 1996 audit, we noted that the county was not negotiating salary increases and had implemented a hiring freeze. Since the hiring freeze in August 1995, the overall employee count has declined considerably. Because of the hiring freeze and the reduced level of staffing since June 1996, the county could save an estimated $10 million from the general fund for salaries and wages of permanent staff for fiscal year 1996-97, over fiscal year 1995-96. However, this savings will be offset by increased overtime costs.

Moreover, through January 1997, the county has not approved any pay increases for its employees. This is a continuation of its policy to maintain or freeze wages until its financial situation improves. Nevertheless, between January and late June 1997, 53 of the 54 bargaining units will be open for negotiations on salaries.

The County Continues To Restructure Its Health Services Delivery System

Since our November 1996 audit, the county has continued to restructure its health care delivery system, which consists of 39 health centers, 6 comprehensive health centers, and 6 hospitals. For instance, it has entered agreements with 24 more private clinics. Agreements with private facilities help increase access to community-based preventive and primary health care services, which is consistent with the goals of the 1115 Waiver. In addition, the county is streamlining the operations at Rancho Los Amigos Medical Center (RLAMC) and

negotiating with a private vendor to fully take over operations beginning in fiscal year 1997-98. However, private vendors appear reluctant to fully take over operation of High Desert Hospital.

As part of its efforts to restructure its health services system, the county implemented or will be implementing the changes described below:

- **As of February 4, 1997, 13 of the county's 39 health clinics were being operated either jointly or solely with private partners.** In our last audit, we noted that private partners solely operated only 6 of the county's health clinics. Since then, private partners have started solely operating 2 more and jointly operating 5 others with the county.

- **The county has entered agreements with 68 private health clinics that will accept county patients through June 30, 2000.** Since our November 1996 report, the county reached agreements with an additional 24 clinics, bringing to 68 the number of private clinics that will accept county patients. These agreements are an important part of the county's efforts to increase outpatient services. The agreements with privately operated clinics allow undocumented aliens to receive services. However, primary care services provided to this patient population are ineligible for federal indigent care matching funds under the 1115 Waiver. Therefore, those costs must be paid with county funds.

- **As of January 23, 1997, RLAMC operations were targeted for transfer to a private vendor, Catholic Healthcare West (CHW), by June 30, 1997.** As the county prepared to transfer the hospital to a private vendor, it reduced the workforce and streamlined the operations during fiscal year 1996-97. For instance, it had eliminated approximately 392 positions at RLAMC as of February 1997. In spite of these reductions, the county estimates the hospital will have an operational shortfall of $28.4 million for fiscal year 1996-97. An operational shortfall indicates more operating expenses than revenue. Such a shortage is covered with moneys from the county's general fund.

  As of February 4, 1997, the county estimates an annual subsidy of $21.6 million for CHW to fully operate RLAMC. Thus, even after its operation is completely transferred to the private vendor, the county may continue to have to

subsidize RLAMC operations. However, this subsidy is approximately $7 million less than the hospital's estimated operational shortfall for fiscal year 1996-97.

- **To date, the county has received only one viable proposal for the privatization of High Desert Hospital.** As a result, the county is developing alternate plans, including exploring opportunities to reconfigure both inpatient and outpatient services. Under the agreement signed in January 1997, High Desert Hospital provides health care services for the United States Immigration and Naturalization Service detainee program at the Los Angeles County Sheriff's Department Mira Loma facility. The hospital will receive additional revenues for providing such services. Also, the county is evaluating the feasibility of accomplishing full privatization over a three-year period.

The Superior Court Ordered Metropolitan Transit Authority Funds Transferred to the Health Services Department Returned

To balance its budget in fiscal year 1995-96, the county transferred $50 million from the Los Angeles Metropolitan Transit Authority to partially cover the budget shortfall within the county Health Services Department (health services). Provisions of state law allowed the county to transfer up to $50 million as a grant for specified purposes. However, the county faces a legal challenge to the transfer.

The State approved SB 727 (Chapter 518, Statutes of 1995) that authorizes, among other provisions, the transfer of $50 million from the county's local transportation fund to be used for funding county-owned and contracted health services. The county transferred $50 million beginning in March 1996 and ending June 1996. On January 7, 1997, the Los Angeles Superior Court issued a judgment stating that SB 727 is unconstitutional and in violation of Article IV, Section 16, of the California Constitution. It prohibited the county from transferring any moneys under SB 727 and ordered the county to return the $50 million plus interest and all other moneys plus interest already transferred. However, the county believes the state law is constitutional and on January 14, 1997, filed its notice of appeal.

The Court of Appeal Ruled That the County Must Repay Recipients for the Reduction in General Assistance Payments

To balance its budget in fiscal years 1995-96 and 1996-97 the county reduced the amount of grants under the general assistance program. This program provides county-funded cash assistance and social services to indigent persons who do not qualify for state or federal aid programs. Provisions of state law allow the county to reduce the amount of cash assistance payments to indigents under certain conditions. However, the county faces several legal challenges to its past reductions.

One legal challenge relates to state approval of the county's reduction in cash assistance payments. In our previous audits, we reported that the county requested the Commission on State Mandates (commission) to find that the county was suffering from significant financial distress and to approve a reduction in its cash assistance payments. In February 1996, the commission approved the county's application for relief from the mandated level of general assistance grants for 12 months. However, on February 29, 1996, a legal challenge was filed against the county and the commission to prevent implementation of the reduction on March 1, 1996. The plaintiffs contend that the commission's finding of significant financial distress was erroneous. The trial court ruled twice in favor of the county in denying the plaintiffs' request for a temporary restraining order and for a preliminary injunction.

In addition, the county faces a legal challenge to a previous reduction in general assistance payments. This challenge arose from the county's reduction of these payments for a two-year period ending in September 1995. This reduction ended because of a lawsuit. The Court of Appeal invalidated the $73 per month medical care reduction and ruled that the county must repay the recipients. The plaintiffs subsequently requested that the Superior Court order the county to issue retroactive payments to eligible recipients for the two-year period of the grant reduction. The Superior Court ruled in the plaintiffs' favor and the county is currently appealing this ruling in the Court of Appeal. The county estimates that the potential liability for retroactive payments will range from $114.9 million to $155.7 million depending on the number of former recipients who can be located and who apply for payment. The Court of Appeal heard arguments on this case on February 19, 1997, and the county is awaiting the court's decision.

The County Could Obtain $860 Million To Repair or Replace the Los Angeles County/University of Southern California Medical Center

As explained in our March 1996 report, the Northridge earthquake that struck in January 1994 damaged approximately 80 county-owned buildings so severely that they were considered unusable. By the end of February 1996, the county had submitted 52 architectural and engineering evaluations—the first phase of the claiming process—to the Federal Emergency Management Agency (FEMA) for funds to repair or replace buildings that were damaged by the earthquake. Two of those unusable buildings are at the Los Angeles County/University of Southern California Medical Center campus (medical center).

On March 12, 1996, the board of supervisors (board) approved a proposal by FEMA to provide approximately $410 million to repair or replace the damaged buildings at the medical center. On January 29, 1997, health services presented the board with its recommendation to modify the medical center to a 750-bed facility from its current 1,353-bed capacity. This reduction would require the county to contract with private health facilities to supplement or replace lost services at the medical center. Additionally, if the county selects the option to modify the medical center, it would receive approximately $450 million of SB 1732 funds. SB 1732 funds are used to reimburse counties for capital construction of health facilities. In addition, SB 1953 requires that, for the medical center to be in compliance with seismic safety, it must be replaced, upgraded, or closed by the year 2008. Counting the SB 1732 funds and the funds from FEMA, the county could receive approximately $860 million to upgrade and repair the medical center if the board approves the 750-bed facility recommendation within the required time.

County of Los Angeles
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DAVID E. JANSSEN
Chief Administrative Officer

March 20, 1997

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

RESPONSE TO PHASE III COUNTY AUDIT

Thank you for the opportunity to comment on the draft version of the Phase III audit that you have conducted of the County of Los Angeles, pursuant to Chapter 518, Statutes of 1995 This is the third of five audits required consistent with legislative authorization transferring $50 million in Metropolitan Transportation Authority funds to the County General Fund for fiscal year 1996-97 budget and the status of the fiscal issues described in previous reports.

In general, we agree with your countywide budget recommendations and in some instances, have already taken action in line with your recommendations. Specifically, the Board of Supervisors, acting as the governing body of the Consolidated Fire Protection District, took definitive action on March 4, 1997 to place a special tax on the June 3, 1997 ballot for voter approval to replace the fire suppression benefit assessment revenues jeopardized as a result of the passage of Proposition 218 in November 1996. The Board additionally approved placement of a special tax on the same ballot to fund County Public Library services and replace community facilities district revenues similarly endangered as a result of Proposition 218

As an ongoing practice and responsibility, we continue to closely monitor the status of the County's budget to ensure operation within the Board-approved appropriations

Once again, we appreciate this opportunity to comment on your draft audit report.

Sincerely,

DAVID E. JANSSEN
Chief Administrative Officer

ALAN SASAKI
Auditor-Controller

DEJ:AS
mmg23
c: Each Supervisor

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps